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In the Supreme Court of the United States

OCTOBER TERM, 1964

No. 35

SECURITIES AND EXCHANGE COMMISSION,
PETITIONER

v.

AMERICAN TRAILER RENTALS COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

OPINIONS BELOW

The oral ruling of the district court (R. 144-148) is unreported. The opinion of the court of appeals (R. 151-161) is reported at 325 F.2d 47.

JURISDICTION

The judgment of the court of appeals was entered on December 9, 1963 (R. 161-162). The petition

for a writ of certiorari was filed on February 12, 1964 and was granted on March 23, 1964 (R. 162, 376 U.S. 948). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a corporate rehabilitation under the Bankruptcy Act, readjusting the rights of widespread public investor-creditors and scaling down their claims for the benefit of stockholders, may be conducted under Chapter XI of the Bankruptcy Act or whether transfer to Chapter X is required.

STATUTES INVOLVED

Chapters X and XI of the Bankruptcy Act (11 U.S.C. 501, *et seq.*, and 701, *et seq.*) are involved in this proceeding substantially in their entirety. The following sections are particularly pertinent:

Section 216(1) of Chapter X (11 U.S.C. 616(1)):

> A plan of reorganization under this chapter—
>
> (1) shall include in respect to creditors generally or some class of them, secured or unsecured, and may include in respect to stockholders generally or some class of them, provisions altering or modifying their rights, either through the issuance of new securities of any character or otherwise;

* * * *

Section 306 (1) of Chapter XI (11 U.S.C. 706 (1)):

For the purposes of this chapter, unless inconsistent with the context—

(1) "arrangement" shall mean any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms;

* * * *

Section 328 of Chapter XI (11 U.S.C. 728):

The judge may, upon application of the Securities and Exchange Commission or any party in interest, and upon such notice to the debtor, to the Securities and Exchange Commission, and to such other persons as the judge may direct, if he finds that the proceedings should have been brought under chapter 10 of this title, enter an order dismissing the proceedings under this chapter, unless, within such time as the judge shall fix, the petition be amended to comply with the requirement of chapter 10 of this title for the filing of a debtor's petition or a creditors' petition under such chapter, be filed. Upon the filing of such amended petition, or of such creditors' petition, and the payment of such additional fees as may be required to comply with section 532 of this title, such amended petition or creditors' petition shall thereafter, for all purposes of chapter 10 of this title, be deemed to have been originally filed under such chapter.

A comparative summary of the pertinent provisions of both chapters is set forth in the Appendix, *infra*, pp. 56-58.

STATEMENT

The issue in this case is whether proceedings for the financial rehabilitation of respondent American Trailer Rentals Company ("the debtor") must be conducted as a corporate reorganization under Chapter X of the Bankruptcy Act rather than as an arrangement of its unsecured debts under Chapter XI of that Act. The issue arises out of the district court's denial of a motion by the Securities and Exchange Commission to dismiss the Chapter XI proceedings, and thus in effect to transfer the proceedings to Chapter X. The motion was made under Section 328 of the Bankruptcy Act, which provides for dismissal of a Chapter XI proceeding if the district judge finds that it "should have been brought under chapter 10 * * *."

A. THE DEBTOR'S ORGANIZATION, OPERATIONS, AND HISTORY OF FINANCIAL DIFFICULTIES.

1. The debtor was organized in 1958 as one of a group of interrelated corporations formed to engage in the automobile-trailer rental business (R. 3, 24, 32). The trailers are of the general utility type that are attached to the rear bumpers of automobiles (R. 3, 29). They are kept at gasoline stations, the operators of which act as rental agents for the debtor (R. 3, 29). The debtor had about 700 such service station agents in December 1961 (R. 22, 24), although the number had declined to about 500 by the time the petition for arrangement was filed a year later (R. 1, 3).

The business was financed largely through the sale of trailers to investors and their simultaneous lease-back. The debtor purchased most of the trailers from an affiliated corporation and placed them with the station operators for rental to the public without the investors ever having seen them (R. 3, 4, 29, 84). From 1959 through 1961 hundreds of investors throughout the Western States purchased and leased back 5,866 trailers, paying an aggregate price of $3,587,439 (R. 3, 26, 31, 32, 66-72, 131-132). Under most of the lease-back arrangements, the trailer owners were to receive a fixed percentage of the purchase price of the trailers—either 2 percent per month for 10 years (under which terms a majority of the trailers were leased back) or 3 percent per month for 5 years (R. 3-4, 32, 98, 132). In a comparatively small number of instances the owners were to receive 35 percent of the rental income (less repair costs) produced by their trailers (R. 4, 32).

Under an agreement made with the debtor in 1960, DeMar, Inc., an affiliated corporation, was given the exclusive right to manufacture the trailers used in the debtor's system (R. 27-28, 64, 67-68). DeMar, which had no other trailer customers (R. 67), manufactured about 90 percent of the total number of trailers in the system (R. 78). Executive Sales Company, another affiliated company, operated through selling agents to sell trailers to members of the public and to arrange for the purchasers to lease their trailers to other affiliated corporations engaged in the trailer-rental business and received a commission on all trailers sold through it. (R.

32, 72, 76, 91). There were a number of these rental corporations, organized in different States, and a purchaser would lease his trailer to the one in his State (R. 68-69, 72-73, 77, 84). The debtor's functions were to maintain the network of service station rental agents, to service and maintain the trailers, to collect the rental fees and to make the payment to trailer owners required under the leasing agreements (R. 24, 30-31, 69). This entire system operated under common control or management.[1] In 1961 Executive Sales and the individual state trailer rental corporations were merged into the debtor (R. 32, 77, 98, 125).

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[1] Executive Sales and the debtor were organized by the same people (R. 32, 61-62) and operated by a common management (R. 44).

I. H. Peters was executive vice president and a director of the debtor, an officer of Executive Sales, an officer of two or more state rental corporations, and a director of DeMar (R. 37, 60-62, 64). Peters arranged the exclusive trailer manufacturing agreement between DeMar and debtor while he was a member of the management of each company, and was compensated by DeMar for this service (R. 67-68). While an officer of the debtor, Peters received individually or through corporations under his control commissions on the majority of the trailers sold (R. 119).

W. N. Marks was president and controlling shareholder of DeMar, a director of debtor, and held irrevocable proxies to more than 141,000 shares (slightly over 32 percent) of debtor's stock (R. 28, 36, 65-66). Marks was a director of debtor when debtor entered into the exclusive trailer manufacturing agreement with DeMar (R. 61-66).

DeMar had an option for an undetermined time to purchase 50,000 shares of debtor's stock at $1.00 per share (R. 39). Clark Hammond was an officer and a director of debtor and an officer in two of the state rental corporations (R. 37-38).

In 1961, after the Securities and Exchange Commission had informed the debtor that the sale and lease-back of the trailers under the foregoing arrangements involved investment contracts and therefore constituted securities required to be registered under the Securities Act of 1933, the debtor discontinued sales of the trailers (R. 33, 47, 84-85). Later in 1961, the debtor filed with the Commission a registration statement covering a proposed offering of such trailer sales and lease-back arrangements (R. 22-51). This registration never became effective (R. 90); instead, in November, 1962, the Commission instituted stop-order proceedings under Section 8(d) of the Securities Act of 1933 (15 U.S.C. 77h(d)), charging that the proposed prospectus contained untrue and misleading statements (R. 10-16). The debtor subsequently consented to the entry of a stop order (R. 17-18, 81-82, 84).[2]

DeMar, which had not been merged with the debtor, filed a petition in bankruptcy after the debtor stopped buying trailers from it in 1961. The debtor had paid DeMar approximately $200,000 for trailers that were never manufactured (R. 4, 64, 67) and an additional $140,000-$150,000 for trailers which were manufactured but never delivered. DeMar had mortgaged the latter trailers to a third party who took possession upon DeMar's bankruptcy (R. 109, 129).

2. Throughout its history, the debtor has never operated at a profit (R. 80). For the three years end-

[2] On June 11, 1963, the Commission entered its findings, opinion and stop order. Securities Act Release No. 4615.

ing September 30, 1961, it had an aggregate income from "gross rentals" of $395,610. In the same period, the debtor made rental payments to trailer owners of $613,021; made payments to station operators of $118,400; and incurred additional "operating expenses" of $668,698. The debtor's business activities during the period resulted in a "net loss" of $504,857, exclusive of special loss items totaling $291,976, which consisted largely of "write off[s] of accounts receivable from former affiliated companies." (R. 31.)[3]

The $613,021 paid to trailer owners included payments to investors whose trailers had not yet been obtained and put into the system. They also included payments pursuant to certain of the "35-percent-of-gross-income" contracts which exceeded 35 percent of actual rental receipts from the trailers involved. (R. 46). In order to make these various payments, the debtor not only borrowed money from its officers, directors, and large stockholders (R. 4, 6, 90-91; see also R. 36, 45, 48), but also borrowed from Executive Sales money which the latter had obtained as commissions on trailer sales (R. 76, 91-92). The debtor thus used funds from the sales of additional trailers to meet its obligations to existing trailer owners. Many of the trailers proved to be de-

[3] These sums are computed from figures set forth in the Summary of Operations in the debtor's registration statement filed in 1961 (R. 30-31). The debtor's auditors stated therein that they were unable to verify the expense items or to express an "overall opinion as to the combined statement of operation" (R. 41).

fective in design or otherwise unsuitable for rental (R. 33, 50, 128). In June, 1961, some 100 trailers were unlocatable and considered lost (R. 46).[4] The debtor also had delivery, promotional, and advertising problems (R. 69).

Prior to November, 1960, at least $140,000, and possibly more, received by Executive Sales from public investors for the purchase of trailers had apparently been misappropriated by members of management (R. 63-64, 76-77, 122-125).[5] Executive Sales was nevertheless obligated to pay DeMar for these trailers, and the debtor assumed this obligation when it merged with Executive Sales (R. 76, 125). Debtor's executive vice president attributed the liability for the sums taken from the debtor "almost com-

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[4] Despite the debtor's obligation under the lease-back arrangements to provide insurance adequate to compensate the trailer owners in the event of theft, damage, or destruction of trailers, the debtor had failed to maintain such insurance (R. 46).

[5] Debtor's executive vice president, I. H. Peters, testified before the Special Master that he thought the amount was about $141,000 (R. 124). In the prospectus filed with the Commission, debtor stated (R. 45-46):

> Prior to November, 1960, certain amounts received for trailers were not expended to purchase trailers. In an agreement dated November 17, 1960, De-Mar, Inc., agreed to manufacturer [sic] all but 57 of these trailers at a cost of approximately $220,000. In September, 1961, De-Mar, Inc. accepted an order for an additional seventeen trailers.
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> On or about October 4, 1961, Executive Sales Company consummated a purchase agreement with another manufacturer for the residual forty trailers. Funds were placed in escrow on or about October 12, 1961, to cover the purchase price of these forty trailers.

pletely" to a deceased member of the original management group (R. 122, 125), but did not feel "qualified to make [the] judgment" that the two remaining members of that group, including one who owned over 15 percent of the debtor's common stock, could be held financially liable for the mismanagement (R. 38-39, 123).

In sum, the debtor received at least $3,590,168 from public investors pursuant to trailer sale and lease-back agreements, but only about 65 percent of that amount, or $2,339,912, had been applied toward acquisition of trailers (R. 31).[6] Of the money the debtor actually paid to acquire trailers, 90 percent or more went to DeMar, the manufacturing affiliate in which certain of the debtor's insiders had an interest (R. 78; and see note 1, *supra*, p. 6).

3. In March 1962, after the debtor had failed in its attempt to register the sale and lease-back agreements (see *supra*, p. 7), I. H. Peters, its executive vice president, and several other persons organized Capitol Leasing Corporation ("Capitol") (R. 5, 78, 93-94). Capitol offered to exchange its stock for trailers on the basis of one share of stock for each $2.00 that purchasers had paid for the trailers (R. 5). After Capitol had acquired 299 of the trailers in exchange for stock,[7] the Commission temporarily sus-

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[6] It appears that two separate sales commissions were taken out of the amounts paid by public investors—one of 20 percent by one of I. H. Peters' companies and another generally ranging from 10 to 17 percent by Executive Sales (R. 74-75, 119).

[7] 88,332 shares of stock of Capitol were exchanged for trailers having "an original cost" of $176,666 (R. 5, 95).

pended the exemption from registration upon which Capitol had relied in making this offer, on the ground that there was reasonable cause to believe that the material used in making the offer contained false and misleading statements (R. 19-21, 154).[8]

B. THE CHAPTER XI PROCEEDINGS.

On December 20, 1962, the debtor filed in the United States District Court for the District of Colorado a petition for and a proposed plan of arrangement under Chapter XI of the Bankruptcy Act (R. 1-8). It stated that its total assets were $685,608, of which $500,000 represented the value of its trailer rental system, *i.e.*, its arrangements with the service station operator agents (R. 137-138).[9] Its stated liabilities were $1,367,890, of which $710,597 was owed to trailer owners under their leasing agreements and $200,677 was owed to investors who had paid for but had not received trailers (R. 4, 137-138). Of the remaining claims, trade and general creditors had claims of $71,805, officers and directors had

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[8] Capitol had relied upon the conditional exemption from registration provided for small issues under Regulation A (17 CFR 230.251, *et seq.*), pursuant to Section 3(a) of the Securities Act of 1933 (15 U.S.C. 77c (a)) (R. 79).

[9] While the proposed plan of arrangement stated that the station rental system (which then consisted of arrangements with some 500 service station operator agents) "was built by the debtor at an estimated cost of $500,000" (R. 3, 5), the debtor's balance sheet in 1961 showed the cost of establishing a system of 700 stations as $33,750 (R. 42, 45). The debtor also estimated in 1961 that the cost of establishing an additional 800 rental stations would be $56,000 (R. 28).

claims for loans to the corporation of $285,277, an accounting firm was owed $15,557, and there was an outstanding bank loan of $40,000 (R. 4).

Under the proposed arrangement, trailer owners are to sell their trailers to Capitol in exchange for Capitol's stock (R. 4-5). They are to receive one share for every $2.00 of "remaining capital investment in the trailers," which is to be determined by deducting from the original purchase price of the trailer the amount which the owners had received as rental payments (R. 4-6).[10] No additional compensation to the owners is provided for the $710,597 of unpaid rentals (R. 4-5). Owners who elect not to exchange their trailers for Capitol's stock receive nothing under the plan (R. 4-7). Investors who paid for but had not received trailers will receive one share of stock for each $2.00 of the purchase price (R. 6). Trade and general creditors are to receive one share of stock for each $3.50 of their claims (R. 6).

The plan of arrangement provides that the debtor will transfer its system (which it states was built at a cost of $500,000) to Capitol in exchange for 107,000 shares, which the debtor will then distribute to its stockholders (R. 5, 7). More than 60 percent of the debtor's stock is held by eight men; seven of them are officers and directors and the eighth is one

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[10] This is less than the exchange that Capitol had offered some months earlier under the exemption from registration which had been suspended, since there trailer owners had been offered one share of stock for each $2 that they had paid with no deductions for so-called "return of capital." See *supra*, p. 10.

of the original promoters of the venture (R. 37-39). The plan further provides that officers and directors will receive one share of Capitol stock for each $5.50 of their claims for loans to the debtor, and that for five years such stock will have limited voting, dividend and liquidation rights (R. 148-150).[11]

C. THE MOTION TO TRANSFER THE PROCEEDINGS TO CHAPTER X.

On February 20, 1963, the Securities and Exchange Commission filed a motion under Section 328 of the Bankruptcy Act to dismiss the Chapter XI proceedings on the ground that the "proceedings should have been originally brought under Chapter X of the Bankruptcy Act because the Debtor's circumstances and capital structure are such that the relief afforded by Chapter XI is inadequate to satisfy the needs to be served * * *" (R. 8-9).

The motion was referred to a referee in bankruptcy as special master for hearing and report (R.

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[11] The plan originally provided that officers and directors would receive one share for each $3.50 of their claims (R. 6). When the district judge denied the Commission's motion to dismiss the proceedings (see below), he further stated (R. 146) that "I do not think that the proposed plan gives the owners of the trailers a fair shake. In other words, unless this plan that is finally determined in this case under the Chapter 11 is such a plan that the investors themselves will have control of this corporation and not the management who got it in this shape, then I say it will be an improper plan." The debtor then modified the plan to reduce the participation of its officers and directors from one share for each $3.50 of their claims to one share for each $5.50, and also to change the method for discharge of the debtor's bank loan and its indebtedness for accounting services (R. 148-150).

51-52). After hearing, he recommended that the motion be denied, on the ground that the Commission had not demonstrated that adequate relief was unobtainable under Chapter XI (R. 133-137), and that final "determination of the Section 328 motion ought to be postponed to the confirmation hearing [on the arrangement]" (R. 135). The district court confirmed and adopted the special master's findings and denied the Commission's motion (R. 143-144). The court stated that it was "not convinced that the needs to be served here can best be met by a Chapter 10"; and that although "there may be in this situation need for new management, and there certainly is some question in my mind as to whether or not the management that is presently * * * operating it, would continue to do so for the best interests of the investors * * * that has not been clearly established yet * * *." (R. 145).

The court of appeals affirmed. It held that "since the granting of the motion rests in the discretion of the court, while we think this is a border-line case, it does not appear that the S.E.C. has shown that adequate relief is not obtainable in Chapter XI proceedings or that there has been an abuse of that discretion warranting reversal." [12]

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[12] The Commission had also filed a petition to intervene in the Chapter XI proceeding to show that, in violation of the anti-fraud provisions of the Securities Act of 1933, the information which the debtor used in procuring acceptances of the plan of arrangement was false and misleading (Tr. 323-352). As the court of appeals explained (R. 159), the Commission alleged, among other things, that "at the time debtor was sending letters to the trailer owners urging them to exchange

SUMMARY OF ARGUMENT

Section 328 of the Bankruptcy Act directs the district judge, upon the application of the Securities and Exchange Commission or of any party in interest, to transfer a proceeding under Chapter XI of the Bankruptcy Act to Chapter X "if he finds that the proceedings should have been brought under" the latter chapter. Chapter XI is not properly invoked "where c. X affords a more adequate remedy * * *" (*General Stores Corp.* v. *Shlensky*, 350 U.S. 462, 467), and this requires a "determin[ation] on the facts of the case whether the formulation of a plan under

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their trailers for shares of Capitol Leasing stock, the president of Capitol and the officers and directors of the debtor were withdrawing their trailers from debtor and were leasing them to another concern engaged in a similar business, and were also urging their relatives to do the same. This was not disclosed to the trailer owners, nor were trailer owners furnished information of Capitol's financial condition or its management. Trailer owners were not told of pending proceedings involving other stock fraud charges against Capitol."

After hearing, a referee in bankruptcy denied the petition to intervene (Tr. 412-417). The district judge granted the petition to intervene but denied the relief sought (Tr. 596-597), and the court of appeals affirmed (R. 159-161). The Commission's appeal on the intervention issue was consolidated with the appeal from the denial of dismissal (R. 151). The court of appeals agreed that "if the stock involved here were not part of an arrangement, the disclosures made with regard to it would be clearly inadequate" and that there was no basis for holding that the investor-creditors here "are not entitled to as much information as are those persons acquiring stock under ordinary conditions" (R. 160). It concluded, however, that appropriate action could be taken by the district court (R. 160-161). We did not seek review of the court of appeals' ruling on this aspect of the case.

the control of the debtor, as provided by c. XI, or the formulation of a plan under the auspices of disinterested trustees, as assured by c. X and the other protective provisions of that chapter, would better serve 'the public and private interests concerned including those of the debtor'" (*id.* at 465).

A. In *Securities and Exchange Commission* v. *United States Realty Company*, 310 U.S. 434, this Court pointed out the numerous respects in which Chapter X of the Bankruptcy Act provides greater protection for public investors than Chapter XI. These include (except where liabilities are less than $250,000) the "appointment of a disinterested trustee" to conduct "a thorough examination and study * * * of the debtor's financial problems and management" and "to send the report to all security holders"; and the formulation and sponsorship of a plan of reorganization by the trustee rather than by the management (*id.* at 449-450). "No comparable safeguards are found in Chapter XI. * * * Every phase of the procedure bearing on the administration of the estate and the development of the arrangement is under the control of the debtor. * * * There are no provisions for an independent study of the debtor's affairs by court or trustee, or for advice by them to creditors with respect to their rights or interests in advance of their consent to the arrangement." (*id.* at 450-451).

We submit that Chapter XI cannot be utilized to readjust the rights of public investor-creditors (as distinguished from readjusting the rights of creditors who are not investors and thereby indirectly affecting

public investors) and that any reorganization that directly changes their rights may be had only under Chapter X. For in such a situation their contract rights should not be altered without the important protections provided by Chapter X.

The facts of the present case dramatically illustrate why public investor-creditors need the protection of Chapter X. The debtor has never operated at a profit and its history and present precarious financial situation raise vital questions as to the best course for the future of the company, which can be answered only after a careful and disinterested study. Chapter XI makes no provision for such study and none has been made or is contemplated in this case. A study by a disinterested trustee is also needed to consider whether new management is required, and to investigate possible causes of action against the old management. The present plan fails to provide sufficient information to enable the public investors to make an informed judgment as to its merits, and a disinterested trustee is needed to advise them with respect to the merits and demerits of any proposed plan. Finally, the plan itself demonstrates that this debtor needs a more comprehensive reorganization than the mere arrangement of its unsecured debts which is permissible under Chapter XI. Here the debtor is not merely "arranging" its unsecured debts. The interest of the trailer owners is being changed from that of creditors of the debtor to stockholders of a successor corporation, and the debtor's business will be taken over by the latter. In any realistic sense, therefore, what is being done in

this case is not an "arrangement" of the debtor's unsecured debts but a "reorganization" of its business, and such a sweeping revamping of the company should be conducted under Chapter X.

B. Transfer to Chapter X was also required to insure that any plan of reorganization will provide "fair and equitable" treatment of the public investor-creditors. Chapter X provides that a plan may not be confirmed unless it is "fair and equitable." Although Chapter XI contained the same standard prior to 1952, it was deleted in that year.

The words "fair and equitable" in Chapter X are " 'words of art' having a well understood meaning in reorganizations * * * that in any plan of corporate reorganization unsecured creditors are entitled to priority over stockholders to the full extent of their debts and that any scaling down of the claims of creditors without some fair compensating advantage to them which is prior to the rights of stockholders is inadmissible." *Securities and Exchange Commission* v. *United States Realty Company*, 310 U.S. 434, 452. This Court has consistently required, in whatever context publicly-held corporations have been reorganized, that investor-creditors must be afforded full compensatory treatment before junior interests may participate. The present plan does not satisfy the "fair and equitable" standard, since the stockholders are being permitted to participate in the reorganized enterprise at the expense of the investor-creditors but without making any contribution to the company.

We submit that *General Stores* establishes that a transfer to Chapter X is mandatory whenever a pro-

posed plan of arrangement is not fair and equitable to public investor-creditors. For the Court there listed, as the first of a series of "typical instances where c. X affords a more adequate remedy than c. XI" (350 U.S. at 467), the following situation (*id.* at 466):

> Readjustment of all or a part of the debts of an insolvent company without sacrifice by the stockholders may violate the fundamental principle of a fair and equitable plan (see *Case* v. *Los Angeles Lumber Products Co.* * * *), as the *United States Realty Co.* case emphasizes.

The deletion of the "fair and equitable" requirement from Chapter XI by the 1952 amendments did not, contrary to the view of the court of appeals, sanction the use of that chapter to deprive public investor-creditors of the protection of that standard. The court of appeals' view is directly contrary to this Court's statement in *General Stores, supra.* Moreover, the legislative history of the 1952 amendments indicates that they were directed to a different problem—the use of Chapter XI for an arrangement of ordinary commercial debts—and were not intended to touch upon the problem of when a Chapter XI proceeding should be transferred to Chapter X.

C. The court of appeals improperly deferred to the discretion of the district court in affirming the order denying transfer. There was no problem here of delicately balancing conflicting considerations, where the trial court's evaluation and judgment might be accorded special weight. On the contrary, here all the pertinent factors compel transfer. The growing

tendency in the lower courts to regard Chapters X and XI as alternative remedies, the choice between which lies largely with the debtor, and to regard the district court's refusal to overturn the debtor's choice of the latter chapter as a matter within its discretion tends largely to nullify the reforms in reorganization law and practice which Chapter X sought to achieve. For the debtor and its trade creditors have strong reason to prefer the "speed and economy" of Chapter XI to the "thoroughness and disinterestedness" of Chapter X (*Realty*, 310 U.S. at 450-451). We therefore urge this Court to make it clear that a district court has no discretion to refuse a transfer where the rights of public investor-creditors are to be readjusted, or, at least, where the proposed arrangement would deny them "fair and equitable" treatment.

ARGUMENT

PROPER PROTECTION OF THE INTERESTS OF THE PUBLIC INVESTOR-CREDITORS OF A FINANCIALLY DISTRESSED CORPORATION REQUIRES THAT PROCEEDINGS FOR ITS REORGANIZATION BE CONDUCTED UNDER CHAPTER X OF THE BANKRUPTCY ACT RATHER THAN UNDER CHAPTER XI.

Section 328 of the Bankruptcy Act (11 U.S.C. 728) in substance directs the district judge, upon the application of the Securities and Exchange Commission or any party in interest, to transfer a proceeding under Chapter XI of the Bankruptcy Act to Chapter X "if he finds that the proceedings should have been brought under" the latter chapter. Conversely, the district judge may not entertain a petition under Chapter X unless he is satisfied that "adequate re-

lief" would not be obtainable under Chapter XI (Sections 141, 146(2), 11 U.S.C. 541, 546(2)). The two chapters are thus mutually exclusive, and Chapter XI is not properly invoked "where c. X affords a more adequate remedy * * *" (*General Stores Corp.* v. *Shlensky*, 350 U.S. 462, 467). "[T]he adequacy of the relief under Chapter XI must be appraised in comparison with that to be had under Chapter X * * *" (*Securities and Exchange Commission* v. *United States Realty Co.*, 310 U.S. 434, 455), and this requires a "determin[ation] on the facts of the case whether the formulation of a plan under the control of the debtor, as provided by c. XI, or the formulation of a plan under the auspices of disinterested trustees, as assured by c. X and the other protective provisions of that chapter, would better serve 'the public and private interests concerned including those of the debtor'" (*General Stores*, *supra*, at 465). Since, as we shall show, Chapter X here "affords a more adequate remedy" than Chapter XI, "it was plainly the duty of the district court in the exercise of a sound discretion to have dismissed the [Chapter XI] petition, remitting respondent if it was so advised to the initiation of a proceeding under Chapter X * * *". (*Realty*, 310 U.S. at 456-457).

Transfer of these proceedings to Chapter X was required for two reasons: *First*, it would be inappropriate to adjust the rights of public investor-creditors without giving them the benefit of the protective procedures which Congress provided in Chapter X for investors, generally. *Second*, since an arrangement under Chapter XI need not satisfy the "fair and equit-

able" standard which a plan of reorganization under Chapter X must meet, use of Chapter XI would permit a reduction in the rights of investor-creditors in order to give the junior security holders who control the management an interest in the reorganized company. In these circumstances, the decision whether to transfer did not turn upon any balancing of conflicting considerations which lay within the discretion of the district court. On the contrary, the undisputed facts of this case made a transfer mandatory.

A. THE PUBLIC INVESTOR-CREDITORS REQUIRE THE PROTECTION WHICH CONGRESS PROVIDED IN CHAPTER X FOR INVESTORS IN CORPORATIONS UNDERGOING REORGANIZATION.

1. INTRODUCTION

In *Securities and Exchange Commission* v. *United States Realty Co.*, 310 U.S. 434, the Court discussed the evils which led Congress to adopt the reorganization provisions of the Bankruptcy Act, and described in some detail the great protections which Chapter X provides for investors. Mr. Justice Stone, writing for the Court, pointed out (*id.* at 448) that among the conditions responsible for the enactment of Section 77B of the Bankruptcy Act, the predecessor to Chapter X, had been—

> * * * the inadequate protection of widely scattered security holders, the frequent adoption of plans which favored management at the expense of other interests, and which afforded the corporation only temporary respite from financial collapse * * *.

In order to protect public investors from overreaching by management in the formulation and im-

plementation of reorganization plans, Congress provided in Chapter X a comprehensive system of safeguards designed "to provide for a larger measure of control by the court over security holders' committees and the formulation of reorganization plans and to secure impartial and expert administrative assistance in corporate reorganizations through participation of the [Securities and Exchange] Commission," which is authorized "to participate generally in the proceedings as a party" with court approval and is required to do so if requested by the court (*id.* at 449, 450). As the Court pointed out, "[a] large measure of control is given to the court over the reorganization * * *, §§ 163, 165, 209, 212, 241-243." Chapter X requires (except where liabilities are less than $250,000) the "appointment of a disinterested trustee" who is to conduct "a thorough examination and study * * * of the debtor's financial problems and management" and "to send the report to all security holders." It is the trustee, and not the management, who formulates a plan of reorganization. Not until the judge approves the plan may it be submitted to creditors. § 176. It is then accompanied by "the report of the Commission and the opinion of the judge approving the plan, § 175."

"No comparable safeguards," the Court noted, "are found in Chapter XI" (*id.* at 450). It "provides a summary procedure by which a debtor may secure judicial confirmation of an 'arrangement' of his unsecured debts" (*id.* at 446). "Every phase of the procedure bearing on the administration of the estate

and the development of the arrangement is under the control of the debtor. The process of formulating an arrangement and the solicitation of consent of creditors, sacrifices to speed and economy every safeguard, in the interest of thoroughness and disinterestedness, provided in Chapter X. * * * The debtor proposes the arrangement * * * and the only opportunity afforded the creditors in respect to the proposed plan is to accept or reject it as submitted by the debtor. * * * There are no provisions for an independent study of the debtor's affairs by court or trustee, or for advice by them to creditors with respect to their rights or interests in advance of their consent to the arrangement. * * * The court in passing upon the arrangement, is * * * faced with the fact that a majority of the creditors have already accepted the plan." *Id.* at 450-451. In short, any successful "arrangement" of the rights of creditors "if accomplished at all, must be without the aids to the protection of creditors and the public interest which are provided by Chapter X * * *" (*id.* at 453).

Because of the protection which Chapter X provided for security holders, this Court held in *Realty* that the district court should have dismissed the Chapter XI petition and left the debtor there to institute a proceeding under Chapter X, "in which it may secure a reorganization which, after study and investigation appropriate to its corporate business structure and ownership, is found to be fair, equitable and feasible, and in the best interest of creditors" (*id.* at 457).

In *General Stores Corp.* v. *Shlensky*, 350 U.S. 462,

465, the Court upheld the lower courts' rulings that Chapter X rather than Chapter XI was required for the reorganization of the corporation there involved. It explained (p. 465) that in *Realty* it had emphasized that, in choosing between the two chapters, it was necessary to determine "whether the formulation of a plan under the control of the debtor, as provided by c. XI, or the formulation of a plan under the auspices of disinterested trustees, as assured by c. X and the other protective provisions of that chapter, would better serve 'the public and private interests concerned including those of the debtor.'" It stated (p. 466) that the "controlling consideration in a choice between c. X and c. XI" is "the needs to be served."

2. THE NEED FOR CHAPTER X PROCEDURES IN THE PRESENT CASE

We submit that these two decisions, read in the light of the basic purposes of the two chapters governing corporate readjustments (see *supra*, pp. 22-23), make it clear that Chapter XI cannot be utilized to readjust the rights of public investor-creditors (as distinguished from a readjustment of the rights of noninvestor-creditors which may indirectly affect investors); and that any reorganization that directly changes their rights may be had only under Chapter X. This is because in such a situation their contract rights should not be altered without the important protection provided by Chapter X—protection designed to give them the benefits of a thorough, impartial investigation of and report upon the conditions that led the debtor into difficulties, an objective eval-

uation of the competency of the management that was responsible therefor and an informed estimate whether new management is required, an independent study of possible causes of action against the management, and an objective analysis of the proposed plan, explaining both its virtues and its problems.

The facts of the present case dramatically illustrate why in such a situation "the formulation of a plan under the auspices of disinterested trustees * * * and the other protective provisions" of Chapter X "would better serve 'the public and private interests concerned * * *'" than its "formulation * * * under the control of the debtor as provided by c. XI" (*General Stores, supra*) and without such protections for investors.

a. *The need for a disinterested trustee to make a thorough examination of the debtor's financial problems and management and to report thereon to the security holders.* The debtor has never operated at a profit. At an earlier period, its management apparently misappropriated substantial corporate funds. Most of the trailers were purchased from an affiliated company; a large number of them, although paid for, were either not manufactured or, if manufactured, were not delivered. The manufacturing company is bankrupt. Only two-thirds of the $3,500,000 contributed by the public investors for the purchase of trailers was used for that purpose; the balance appears to have been drained off in high commissions taken by the management on the sale of the trailers' to the public. Portions of these commissions

on new trailer sales were, in turn, used by the management to pay prior purchasers of trailers the high rentals which they had been promised—running as much as 36 percent a year on their investment. When the debtor filed its petition for an arrangement, its stated liabilities of $1,367,890 were approximately double its stated assets of $685,608; most of the latter ($500,000), however, represented the alleged value of the trailer rental system, *i.e.*, the debtor's arrangements with the service station operators (see Statement, *supra*, p. 11).

In short, the debtor always has been in precarious financial condition, and apparently it was hopelessly insolvent, in both the bankruptcy and the equity sense, when the arrangement was sought. The debtor's disastrous financial history and unhappy operating experience immediately raise two vital questions: (1) why did it get into this predicament, and (2) what, if anything, can be done to remedy the situation, to put the company on a sound financial footing, and to prevent a recurrence of those disasters? Those basic questions in turn raise other fundamental problems —are the debtor's difficulties due to outside circumstances, general economic conditions in the industry, managerial incompetence or chicanery, or other factors? These obviously difficult questions require careful study, but unless and until they are answered it is impossible to write any meaningful prescription for the future economic health of the company.

Chapter XI, of course, makes no provision for such a study, and none has been made, or is intended to be made, in this case. But without such a study there

is no way of even attempting to predict, in a financial situation such as this, whether in the long run the company or creditors will really be any better off after the arrangement than it was before. True, the arrangement may temporarily solve the most pressing immediate financial problems—in this case, at the expense of the public investor-creditors and for the benefit of the stockholders, see *infra*, pp. 40-41—but such temporary relief may not even touch upon the real ills and needs of the enterprise.

Under Chapter X, as the Court explained in *Realty* (310 U.S. at 449-450), there would be "a thorough examination and study by the trustee of the debtor's financial problems and management." Section 167 (1), (2), (5), 11 U.S.C. 567(1), (2), (5). "The trustee is required to report the result of his study, to send the report to all security holders with notice to submit to him proposals for a plan of reorganization." Only by such a comprehensive analysis can the real causes of the debtor's difficulties be ascertained, and the proper methods for correcting them be established. Only Chapter X provides the procedure.

b. *The need for a disinterested trustee to recommend whether new management is required.* The district court recognized (R. 145)—as it necessarily had to do in the light of the facts in the record (see *supra*, pp. 7-11)—that "there may be in this situation need for new management, and there certainly is some question in my mind as to whether or not the management that is presently * * * operating it, would continue to do so for the best interests of the

investors." The court nevertheless did not find this to be a fact calling for transfer to Chapter X, since "that has not been clearly established yet" (R. 145); and it suggested (R. 145-146) that "if there is any indication of any criminal activity on the part of the people who are running the company, this should by the SEC be investigated and if found that there is any or has been any criminal activity should be reported to the proper authorities in the Justice Department."

But the whole purpose of transferring the proceeding to Chapter X is to give the independent trustee the opportunity to conduct a searching inquiry to determine whether new management is required. Such an inquiry plainly is required where the district court itself recognizes, as it did here, that "there may be * * * need for new management" and that there is doubt whether the existing management would continue to operate the company "for the best interests of the investors." The purpose of such an investigation is not to determine whether the management has violated the federal securities laws—although if it had, this plainly would bear upon its qualification to continue to hold its present positions of trust and confidence—but to ascertain whether the financial and operating changes necessary to solve the debtor's problems may not also require new people to make them effective. "Readjustment of the debts may be a minor problem compared with the need for new management. Without a new management today's readjustment may be a temporary moratorium before

a major collapse." *General Stores Corp.* v. *Shlensky*, 350 U.S. 462, 466.

c. *The need for a disinterested trustee to investigate possible causes of action against the management.* One of the innovations which Chapter X introduced into the reorganization process is the requirement that the trustee "report to the judge any facts ascertained by him pertaining to fraud, misconduct, mismanagement and irregularities, and to any causes of action available to the estate" (Section 167(3), 11 U.S.C. 567(3)). In the present case, such an investigation of and report on possible causes of action by the debtor against its past and present management plainly was necessary. For the debtor may have valid claims arising out of the substantial sums which apparently were misappropriated from it, the large additional amounts paid for trailers never manufactured or delivered to it, the granting to DeMar (which was affiliated with the debtor) of the exclusive contract to manufacture trailers, the delivery by DeMar of defective and unusable trailers, and the substantial portion of the amounts paid by public investors for trailers that was siphoned off through the high commissions charged on trailer sales (see *supra*, pp. 9-10). Investigation might also indicate the need to subordinate the debt claims which the management has against the debtor (R. 4, 6) to the claims of the public investor-creditors. Cf. *Taylor* v. *Standard Gas and Electric Co.*, 306 U.S. 307; *Mecca Temple* v. *Darrock*, 142 F. 2d 869 (C.A. 2),

certiorari denied, 323 U.S. 784; *In the Matter of Texas Portland Cement Co.*, 205 F. Supp. 159 (E.D. Tex.), note 13, *infra*.

There is no method by which such an investigation can be made under Chapter XI, and none either has been made or is contemplated. For, as Mr. Justice Douglas stated in testifying as Chairman of the Securities and Exchange Commission on the proposed corporate reorganization provisions in 1937, "a debtor in possession cannot be expected to investigate itself". (Hearings on H.R. 6439 before the House Committee on the Judiciary, 75th Cong., 1st Sess., 175-176). Only an independent trustee appointed under Chapter X can and would make such a study. While it cannot be predicted whether an investigation in this case would ultimately produce any tangible benefits for the debtor,[13] there is certainly enough in this record

[13] There have been a number of recent cases in which comprehensive investigations by Chapter X trustees have resulted in substantial benefits and recoveries on behalf of the debtors' estates. See *Twenty-Eighth Annual Report of the Securities and Exchange Commission* (Government Printing Office: (1963) 98. For example, in *In the Matter of Texas Portland Cement Co.* (E.D. Tex., No. 1606), such investigation led to a reduction in the debtor's total indebtedness from approximately $5,200,000 to about $3,150,000 and the cancellation or surrender of almost 215,000 shares of capital stock. The confirmed plan of reorganization also provided for the subordination to public securityholders of certain claims of the debtor's directors who had not settled with the trustee. 205 F. Supp. 159, 162 (E.D. Tex. 1962). In *In the Matter of Shawano Development Corporation* (D. Wyo., No. 3163), the trustee has instituted actions against twenty-two defendants on the basis of the investigation conducted, and approximately $3,000,000 is claimed. *In the Matter of DePaul Educational Aid Society*, (N.D. Ill., No. 59 B 41), involved a claim which

to warrant a comprehensive inquiry. "Readjustment of the debt structure of a company, without more, may be inadequate unless there is also an accounting by the management for misdeeds which caused the debacle" (*General Stores, supra,* 350 U.S. at 466).

d. *The need for a disinterested trustee to formulate the plan of reorganization and to advise the security-holders thereon.* Under Chapter XI the debtor itself formulates the plan of adjustment, and it is no surprise that the plan which the debtor here proposes requires the public investors to accept a significant reduction in their interest in the company. The plan, however, fails to provide sufficient information to enable the public investors to make an informed judgment as to its merits, but instead gives them no practical alternative but to accept it; makes no attempt to explain why such sacrifice is required; and offers

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was discovered upon investigation and was settled by a creditor agreeing to reduce its claim by 45 percent.

In *In the Matter of Automatic Washer Company* (S.D. Iowa, No. 5-426), the trustee after investigation obtained a judgment for the debtor of $406,250 and also recovered some $90,000 in settlement of claims, including one for fraud in the alleged sale of machinery to the debtor. In *In the Matter of Swan-Finch Oil Corp.* (S.D. N.Y., No. 93046), the trustees have instituted various actions including a suit for $6 million and have effected very substantial recoveries on behalf of their estates as a result of their investigations. *Twenty-Ninth Annual Report of the Securities and Exchange Commission* (Government Printing Office: 1964) 90-91. See also *Pettit and Crawford, Trustees* v. *Doeskin Products, Inc.*, 270 F. 2d 95 (C.A. 2), rehearing denied, *id.* at 699, and *Pettit and Crawford, Trustees* v. *Olean Industries*, 266 F. 2d 833 (C.A. 2).

no appraisal of the likelihood of successful operation if it is adopted.

The typical investor-creditor of the debtor has (1) a trailer, which, if it can be found, will be located at a gasoline service station probably hundreds of miles from his residence, (2) a contractual right to receive a fixed rent from the debtor for his trailer, and (3) a substantial claim against the debtor for past rent. Investors who have paid for but have not received their trailers have a claim for the purchase price. The proposed arrangement requires the investor-creditors to surrender their trailers, their right to future rent and their claims for unpaid rent or for their purchase price, and to take in return stock in a corporation newly organized by persons affiliated with the debtor. The amount of stock the investor-creditors are to receive is to be determined not by the actual value of the trailers they are asked to sell nor by the value of their claims to past or future rent. Instead, investor-creditors are to receive one share of stock of the new corporation for every $2.00 of their "remaining capital investment," calculated on the basis that any rent which a trailer owner may have received was actually a return of capital rather than income, as he presumably assumed when he made his investment.

The plan of arrangement is silent with respect to a number of important things which the investor-creditors should know if they are to make an informed judgment on whether to accept or reject it. For example, the plan does not state the consequences if an investor rejects it. Presumably he is free to take pos-

session of his trailer, if he can find it; the plan does not indicate what effort, if any, the debtor or its successor will make to aid him in doing so. Nor does it state whether a non-accepting investor's claim for back rentals is wiped out, or whether it may be asserted against Capitol, the successor corporation.

The plan is written so as to confuse rather than help an unsophisticated investor. For after first stating that "Unsecured debts shall be paid and satisfied as follows," it then goes on to provide that the $710,-597.53 due the trailer-owners shall be "satisfied" by the issuance to them of Capitol stock, upon receipt of certificates of title to the trailers, on the basis of one share for each $2 remaining capital investment in the trailers (R. 6). An unsophisticated investor reading this description of the plan might not realize that the stock he is to receive is in exchange for his remaining investment in the trailer, and that his claim for unpaid rent is being "paid and satisfied" by his giving it up.

The plan contains no estimate of future earnings of the reorganized company, no indication of how the management intends to change the operation which thus far has been unsuccessful, and no reasons why the management believes that the proposed changes are likely to produce a successful venture. All that the plain contains with respect to those vital matters is the brief statement (R. 7-8):

> The proponents of this plan believe that it is feasible—and submit that the adoption of the plan by trailer owners and creditors will allow

Capitol Leasing Corporation and the debtor the opportunity to combine their resources with the result that the business operation may be carried on successfully. Unless the plan is adopted, proponents suggest that creditors will receive little, if anything, in settlement of debtor's obligation to them, and that trailer owners may find themselves unable to realize any value for their trailers or any income from their operation.

This threat of disaster unless the investor-creditors accept the plan, coupled with the lack of the detailed facts which they need to make an intelligent judgment, makes a mockery of the choice which the plan purports to offer. An investor-creditor can either attempt to obtain possession of his trailers (which presumably he never wanted) or give up the trailers and claims against the debtor for stock in a corporation about which he is given virtually no information. Should any investor-creditors adopt the first alternative, they are warned they may not be able to "realize any value for their trailers" and they are left unclear whether their past claims are wiped out. Should they adopt the second, they would receive an interest in a corporation about which they know almost nothing except that there is cause for concern about the management's competency or good faith.

The short of the matter is that here, just as in *Securities and Exchange Commission* v. *Liberty Baking Corp.*, 240 F. 2d 511, 515 (C.A. 2), certiorari denied, 353 U.S. 930, the investors affected "cannot competently appraise [the] proposed plan without the educated advice of [a] * * * disinterested person."

Cf. *Mecca Temple* v. *Darrock*, 142 F. 2d 869, 871 (C.A. 2); certiorari denied, 323 U.S. 784, where the court assumed that many of the public investors "do not even know of the pendency of these proceedings, and that many who have been informed suffer from a grave lack of accurate information as to the true state of affairs." In each of those cases the Second Circuit, in reversing a district court's refusal to transfer a Chapter XI proceeding to Chapter X, gave significant weight to the fact that under Chapter XI the public investors would not be given the necessary information which a Chapter X trustee would furnish. The same consideration is equally persuasive in favor of transfer here.

Finally, in view of the Commission's charge that the management made false and misleading statements in soliciting acceptances of the plan (see note 12, *supra*, pp. 14-15), and the court of appeals' recognition (R. 160) that "if the stock involved here were not part of an arrangement, the disclosures made with regard to it would be clearly inadequate," there is reason to question whether any additional information which the present management might furnish to the public investor-creditors would provide a full and objective analysis of the plan, including its deficiencies as well as its virtues.

e. *The need for a more comprehensive reorganization than a mere arrangement of unsecured debts under Chapter XI.* The proposed plan on its face involves more than a mere "arrangement" of the company's unsecured debts. In a typical Chapter XI ar-

rangement, unsecured creditors may extend the maturity of their indebtedness, change its terms or reduce its principal amount, or agree to any combination of these things. After the arrangement, however, they still remain unsecured creditors, and the debtor continues in its same corporate form.

Under the present plan, however, the company is doing something quite different from simply "arranging" its unsecured debts. It is turning its business over to another corporation, and it is eliminating those debts by converting its creditors into stockholders in the new company. In connection with such conversion, the creditors are turning their own property and claims over to the new corporation in exchange for the latter's stock. If the arrangement is consummated, the public investor-creditors will have ceased to exist as such, and the debtor presumably will be liquidated, since its business will be conducted by its successor. There would thus be a complete change in both the form and the financial structure of the business.

Moreover, the claims of trailer owners are not ordinary unsecured debts of the company. These creditors acquired title to their trailers in order to secure payment of the amounts to be paid to them, creating what in economic substance is a secured claim.[14] Un-

[14] The accounting treatment of such claims is of interest. It is not clear whether or not the amounts to become due to trailer owners would have to be shown on the debtor's balance sheet as a liability. See Accounting Research Bulletin No. 38 (American Institute of Accountants, 1949), dealing with sale and lease-back arrangements. If such amounts were required to appear as a liability, which is quite possible, then

der the plan they are to relinquish this secured interest. The desire of the debtor to eliminate that interest is presumably one reason for the proposed structural changes in the business. Chapter XI, of course, is available to readjust only "the rights of unsecured creditors of the debtor * * *" (*Realty*, 310 U.S. at 452; Section 306(1), 11 U.S.C. 706(1)).

What is involved in this case, therefore, in any realistic sense is not an "arrangement" of the debtor's unsecured debts but a "reorganization" of its business. Even if this far-reaching revamping of the debtor's capital structure and form could come within the statutory definition of "arrangement" in Chapter XI,[15] we submit that a corporate reorganization which goes beyond a simple "adjustment" of unsecured debts should be conducted as a reorganization under Chapter X and not as an adjustment under Chapter XI. Cf. *Securities and Exchange Commission* v. *United States Realty Co.*, 310 U.S. 434, 447, 456. Here the breadth of the plan which management itself has proposed fully confirms what is obvious from the history and present financial predicament of the debtor, namely, that "this business needed a more pervasive reorganization than is available under c. XI" (*General Stores, supra*, 350 U.S. at 468).

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they should be shown as secured by the trailers. See Securities and Exchange Commission Regulation SX, Rule 5-02(30), 17 CFR 210.5-02(30).

[15] Section 306(1) of the Bankruptcy Act (11 U.S.C. 706(1)) defines "arrangement" for the purposes of Chapter XI as—

> * * * any plan of a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms.

B. THE USE OF CHAPTER X IS REQUIRED TO INSURE THAT ANY PLAN OF REORGANIZATION IS "FAIR AND EQUITABLE" TO THE PUBLIC INVESTOR-CREDITORS.

Chapter X requires that, before the judge may confirm a plan of reorganization, he must be satisfied that "the plan is fair and equitable, and feasible" (Section 221(2), 11 U.S.C. 621(2)). Prior to 1952, Chapter XI contained the same standard. In that year, however, it was amended to delete the requirement that the plan be "fair and equitable" (66 Stat. 433), and it now requires only that the plan be, among other things, "feasible" (Section 366(2), 11 U.S.C. 766(2)).

The words "fair and equitable" in Chapter X are " 'words of art' having a well understood meaning in reorganizations * * * that in any plan of corporate reorganization unsecured creditors are entitled to priority over stockholders to the full extent of their debts and that any scaling down of the claims of creditors without some fair compensating advantage to them which is prior to the rights of stockholders is inadmissible." *Securities and Exchange Commission* v. *United States Realty Co.*, 310 U.S. 434, 452. This Court has consistently required, in whatever context publicly-held corporations have been reorganized, that investor-creditors must be afforded full compensatory treatment before junior interests may participate. See *e.g.*, *Northern Pacific Railway* v. *Boyd*, 228 U.S. 482, 502, 504 (equity receivership); *Case* v. *Los Angeles Lumber Co.*, 308 U.S. 106, 115-116 (reorganization under Section 77B of the Bankruptcy Act); *Consolidated Rock Products Co.* v. *DuBois*, 312 U.S. 510, 527-529 (reorganization under Section 77B of the

Bankruptcy Act); *Ecker* v. *Western Pacific R. Corp.*, 318 U.S. 448, 484 (railroad reorganization under Section 77 of the Bankruptcy Act); *Otis & Co.* v. *Securities and Exchange Commission*, 323 U.S. 624, 633-640 (reorganization under the Public Utility Holding Company Act of 1935). As explained in *Consolidated Rock Products*, 312 U.S. at 527, 529:

> "any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights" of creditors "comes within judicial denunciation." *Louisville Trust Co.* v. *Louisville, N. A. & C. Ry. Co.*, 174 U.S. 674, 684. * * *
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> If [creditors] receive less than * * * full compensatory treatment, some of their property rights will be appropriated for the benefit of stockholders without compensation. That is not permissible. * * *.

The present plan does not satisfy the "fair and equitable" standard. Since the debtor is insolvent, the entire enterprise, whatever its value, belongs to the creditors; and the stockholders cannot participate unless they contribute some additional money or property to the reorganized enterprise. The stockholders here are not making any such contribution; the suggestion in the plan that they are, because the debtor will transfer its rental system to the new corporation (R. 5), ignores the fact that since the debtor is insolvent its system belongs to the creditors, not to the stockholders. The plan proposes the distribution to the stockholders of the 107,100 shares of Capitol stock to

be issued to the debtor in exchange for its trailer-rental system; to that extent the "property rights [of the public investor-creditors] will be appropriated for the benefit of stockholders without compensation" (*Consolidated Rock Products, supra*). There is thus present in this case that "scaling down of the claims of creditors without some fair compensating advantage to them which is prior to the rights of stockholders" which, according to *Realty*, "is inadmissible." The extent of the inadmissible scaling down of the investor-creditors' rights is reflected in the fact that they are to receive no compensation for the $700,000 back rent owing to them, and that the rent already received is to be treated retroactively as a return on capital.

Thus, if the present arrangement were part of a plan of reorganization under Chapter X, it could not be approved as "fair and equitable." The question is whether that standard, designed to protect creditors of a financially-distressed corporation from having their claims diminished for the benefit of junior interests, may be avoided by proceeding under Chapter XI.

We submit that *General Stores* establishes that a transfer to Chapter X is mandatory whenever a proposed plan of arrangement is not fair and equitable to public investor-creditors. For the Court there listed, as the first of a series of "typical instances where c. X affords a more adequate remedy than c. XI" (350 U.S. at 467), the following situation (*id.* at 466):

> Readjustment of all or a part of the debts of an insolvent company without sacrifice by the

stockholders may violate the fundamental principle of a fair and equitable plan (see *Case* v. *Los Angeles Lumber Products Co.*, * * *), as the *United States Realty Co.* case emphasizes.

In *Realty* transfer to Chapter X was required because, even though Chapter XI then contained the "fair and equitable" standard, its procedures were not adequate to insure that the standard would be met (310 U.S. at 453-454). The present case seems *a fortiori*, since here "fair and equitable" treatment would be provided only under Chapter X.[16]

Thus, Chapter XI may not be utilized where the plan requires the investor-creditors to give up part of their claims without some compensating "sacrifice by the stockholders." To permit Chapter XI to be utilized in that situation would run counter to the numerous decisions of this Court refusing to permit a corporate reorganization in which senior interests did not receive "fair and equitable" treatment. See the cases cited *supra*, pp. 39-40. It would also ignore the fact that one of the evils which gave rise to the reorganization provisions of the Bankruptcy Act was,

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[16] Our argument assumes—and we do not understand the respondent to dispute it—that the proposed plan of arrangement in the present case does not meet the fair and equitable standard. See *supra*, pp. 40-41. But even if that issue were less clear than we believe it to be, that would not justify the denial of transfer. For, as *Realty* makes clear (310 U.S. at 454), the determination whether the present plan is fair and equitable "obviously cannot be answered with any assurance in the present case without resort to the facilities for investigation of the financial condition and structure of the debtor * * * and to the expert aid and advice of the Commission available under Chapter X."

"the frequent adoption of plans which favored management at the expense of other interests" (*Realty*, 310 U.S. at 448).

The court of appeals, however, concluded that the 1952 amendments of Chapter XI sanction the use of that chapter for an arrangement which does not provide fair and equitable treatment of investor-creditors (R. 157-159). It relied on provisions of those amendments which (a) deleted from Chapter XI the requirement that the plan be fair and equitable, and (b) added a provision stating that confirmation of an arrangement "shall not be refused solely because * * * the interests of [a corporate debtor's] stockholders or members will be preserved" thereunder (Section 366, 11 U.S.C. 766).

The court of appeals' conclusion is directly contrary to this Court's statement in *General Stores*, *supra*, pp. 41-42, that the failure of a plan of arrangement under Chapter XI to satisfy the fair and equitable standard would call for the use of Chapter X. The *General Stores* decision was rendered in 1956, four years after the 1952 amendments. That this Court was fully aware of those amendments when it made the statement in *General Stores* is shown by the reliance upon those amendments in the dissenting opinion. 350 U.S. at 471-472.

In other words, the fact that a plan of arrangement under Chapter XI need no longer satisfy the "fair and equitable" standard may be the very reason why that chapter does not provide adequate relief where the interests of public creditors are being ad-

versely affected for the benefit of junior security holders. Thus, in *Securities and Exchange Commission* v. *Liberty Baking Corporation*, 240 F. 2d 511, 515 (C.A. 2), certiorari denied, 353 U.S. 930, the court stated that because there was "a grave question whether the plan would deprive creditors of their 'absolute priority' rights as against stockholders, * * * the need for resort to Chapter X is much greater than was the need in General Stores."

Moreover, the legislative history of the 1952 amendments indicates that they were directed to a different problem—the use of Chapter XI for an arrangement of ordinary commercial debts—and were not intended to touch upon the problem of when a Chapter XI proceeding should be transferred to Chapter X. The deletion of the "fair and equitable" standard from Chapter XI was viewed as a mere "clarifying" and "uncontroversial" amendment.[17] It would hardly have been so described if it had been intended to effect substantive changes in the law governing

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[17] H. Rep. No. 2320, 82d Cong., 2d Sess., pp. 2-3. See also S. Rep. No. 1395, 82d Cong., 2d Sess., p. 20, where, in a letter to the Chairman of the Senate Judiciary Committee, the Assistant Director of the Administrative Office of the United States Courts stated, with respect to the Senate bill embodying the 1952 amendments, that it was "designed to correct certain inaccuracies, ambiguities, and minor imperfections in the National Bankruptcy Act that have been revealed since the enactment of the Chandler Act in 1938. Nearly all of the proposals are regarded as noncontroversial in character." A chart prepared by the National Bankruptcy Conference, which initiated these amendments, classified Section 35 of the bill, deleting the "fair and equitable" language, as a "perfecting or clarifying" amendment. *Id.*, at 23.

the transfer of Chapter XI proceedings to Chapter X.[18]

A more probable explanation of the amendment is that Congress was merely recognizing the fact, to which the *Realty* case had referred, that a conventional composition with trade creditors under Chapter XI could hardly involve the absolute priority doctrine, since by definition such a composition modifies the claims of these creditors without alteration of the rights of stockholders.[19] This explanation of the 1952

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[18] This conclusion is supported by the fact that the same legislation added Section 328 to Chapter XI, which specifically authorizes the Securities and Exchange Commission or any party in interest to apply for the dismissal of a Chapter XI proceeding unless it should in effect be transferred to Chapter X. The House Committee Report states that this section "codifies the law of the United States Realty & Improvement case" (H. Rep. No. 2320, 82d Cong., 2d Sess., p. 19). This apparently refers to the procedure sanctioned in that case of moving to dismiss the Chapter XI proceeding. The Report, however, in the previous paragraph had referred to the substantive holding of *Realty*, and, if the legislation had been intended to alter that holding, the Report would certainly have criticized it.

[19] Cf. *Realty*, 310 U.S. at 454:

> While this means that arrangements of unsecured debts of corporations, like respondent, may not be "in the best interests of creditors" and "feasible" under Chapter XI, it does not mean that there is no scope for application of that chapter in many cases where the debtor's financial business and corporate structure differ from respondent's. This is especially the case with small individual or corporate business where there are no public or private interests involved requiring protection by the procedure and remedies afforded by Chapter X. In cases where subordinate creditors or the stockholders are the

legislation realistically reflects the different economic positions of public investor-creditors and ordinary commercial creditors, and explains why Congress was willing to permit the claims of the latter, but not of the former, to be cut down in a Chapter XI arrangement.

For it is one thing if informed business men, in order to retain a customer which is seeking to extricate itself from financial difficulties, are willing to accept a reduction of their claims without any change in the junior security interests. It is quite another, however, if public investor-creditors are required to accept less than their full claims in a reorganization because junior interests propose a plan under which they themselves participate. Commercial creditors, moreover, normally extend credit for short periods on the expectation that cash generated from current operations will be adequate to assure payment; their credit risks reflect basically an appraisal of short-term prospects, as indicated by the debtor's current assets and liabilities. Public investor-creditors, on the other hand, are seldom close to the management or operations of the debtor; they expect to recover their investment at the end of a stated period and the quality of their investment is dependent not only on the debt-

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managers of its business, the preservation of going-concern value through their continued management of the business may compensate for reduction of the claims of the prior creditors without alteration of the management's interests, which would otherwise be required by the *Boyd* case See *Case* v. *Los Angeles Lumber Products Co., supra,* [308 U.S. at pages] 121, 122.

or's ability currently to meet its obligations but also on the over-all asset coverage for their claims, represented by the equity capital contributed by the stockholders. A composition of the public investor-creditors' claims diverts to the stockholders, for whose benefit the loan was made, the very values upon which these creditors depended in making the loan, and without affording them an opportunity for recoupment.

In these circumstances, the court below erred in thinking that support for its decision below could be drawn from the statement in the House Committee Report on the 1952 amendments that those changes were (R. 158) "designed to remove the fair and equitable provision, and * * * made clear that the rule of the Boyd and Los Angeles cases shall not be operative under those three chapters [Chapters XI, XII, XIII]" (H. Rep. No. 2320, 82d Cong., 2d Sess., p. 21). For, as we have indicated, the apparent reason for the deletion of the "fair and eqiutable" standard from Chapter XI was not to change the principles governing transfer to Chapter X, but to make it clear that an ordinary composition with trade creditors could be effected under Chapter XI. This conclusion is supported by the following statement in the House Committee Report, which precedes the language quoted by the court of appeals:

> In fact, however, the fair and equitable rule * * * cannot realistically be applied in a chapter XI, XII, or XIII proceeding. Were it so applied, no individual debtor and, under chapter XI, no corporate debtor where the stock ownership is substantially identical with management could effectuate an arrangement except by payment of the claims of all creditors in full.

> Chapter XI has replaced the old composition procedure under former section 12 of the Bankruptcy Act, where the fair and equitable rule did not apply. Nor is it practicable or realistic to apply the rule in a proceeding under chapter XI, XII, or XIII.[20]

In other words, removal of "the fair and equitable" requirement from Chapter XII, dealing with real property arrangements and explicitly inapplicable to corporations (Section 406(6), 11 U.S.C. 806(6)), from Chapter XIII, dealing with wage earners' plans and applicable only to individuals (Section 606(8), 11 U.S.C. 1006(8)), and from Chapter XI, which, unlike Chapter X, may have individuals as well as corporations as the subject of proceedings, was intended to make arrangements possible for individuals or for privately-held corporate debtors. It was not intended to permit the rights of investor-creditors to be readjusted.

Moreover, our view is also consistent with the legislative history of Chapter XI showing that it was designed primarily to enable small businesses to effect compositions with trade creditors.[21] Cf. *Realty*, 310

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[20] H. Rep. No. 2320, 82d Cong., 2d Sess., p. 21. See also S. Rep. No. 1395, 82d Cong., 2d Sess., pp. 11-12.

[21] This Court pointed out in *Realty*, 310 U.S. at 450, fn. 8, that "Chapter XI was sponsored by the National Association of Credit Men and other groups of creditors' representatives expert in bankruptcy." *Id.* at 450, fn. 8. See Hearings on H. R. 6439 before the House Committee on the Judiciary, 75th Cong., 1st Sess., p. 47, where one of the draftsmen of Chapter XI testified that its provisions were designed for the debtor who was "interested in making a composition with his mer-

U.S. at 447, where the Court pointed out that Chapter XI was "specifically devised to afford * * * procedures * * * adapted * * * to composition of debts of small individual business[es] and corporations with few stockholders * * *."

In short, the deletion of the "fair and equitable" standard from Chapter XI "had nothing whatsoever to do with the question of which procedure was to be required in a particular case; it dealt only with the [standards for] confirmation of an arrangement after that procedure had been decided upon and substantially completed," *i.e.*, in cases where Chapter XI was properly invoked. *Grayson-Robinson Stores, Inc.* v. *Securities and Exchange Commission*, 320 F. 2d 940, 952 (C.A. 2) (dissenting opinion of Judge Clark on petition for rehearing *en banc*).

C. THE DENIAL OF TRANSFER CANNOT BE UPHELD AS A VALID EXERCISE OF THE DISTRICT COURT'S DISCRETION.

1. In affirming the district court's denial of transfer, the court of appeals relied primarily on its view that the matter lay within the discretion of the trial court. For the appellate court stated (R. 159): "[S]ince the granting of the motion rests in the dis-

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chandise creditors." And see the statement of a representative of the National Bankruptcy Conference at the hearings, *id.* at 45:

> Subsection I [Chapter XI] is no different from the present section 12 which has been with us for year[s], except that it allows wider rights. A man goes in, who has a little business as a druggist, and wants to make a composition with his creditors.

The ases for which Chapter XI was intended were also refe..ed to in the hearings as "hot-dog stand" cases (*id.* at 175).

cretion of the court, while we think this is a borderline case, it does not appear that the S.E.C. has shown that adequate relief is not obtainable in Chapter XI proceedings or that there has been an abuse of that discretion warranting reversal."

Such deferral to the discretion of the district court was unwarranted. There was no problem here of delicately balancing conflicting considerations, where the trial court's evaluation and judgment should be accorded special weight. On the contrary, as we have shown, here all the pertinent considerations require transfer. The record can be searched in vain for any factors that support utilization of Chapter XI here, let alone outweigh the factors that call for transfer to Chapter X.

Nor can this Court's decision in *General Stores* fairly be read as indicating that the decision whether to transfer in this case was a matter within the discretion of the lower courts. In that case the district court had ordered transfer, and the court of appeals had affirmed. This Court, after pointing out (350 U.S. at 468) that it "was the view of two lower courts" that the debtor there "may well need a more thoroughgoing capital readjustment than is possible under c. XI," stated (*ibid.*): "We could reverse them only if their exercise of discretion transcended the allowable bounds. We cannot say that it does. Rather, we think that the lower courts took a fair reading of c. X and the functions it serves and reasonably concluded that this business needed a more pervasive reorganization than is available under c. XI."

The Court's broad statement of deferral to the discretion of the lower courts must be read in the light of the case before the Court. For the Court made that statement only after it had summarized the numerous factors which indicated that "the needs to be served" required use of Chapter X (*id.* at 467-468), and it immediately followed it with limiting language indicating that the lower courts had "reasonably concluded" that the public interest there required Chapter X. In other words, the Court was merely ruling that, on the record before it, both courts had correctly concluded that transfer was required. There is certainly no implication in *General Stores* that if both lower courts there had refused to transfer, this Court would have deferred to such action as a valid exercise of discretion. Indeed, the *Realty* case itself, where the district court refused to transfer and the court of appeals dismissed the appeal, makes it clear that if such refusal is improper, this Court will correct the error.

In this case, unlike *General Stores*, the decisions of the lower courts have "transcended the allowable bounds." Here, as was the situation in *Realty* (310 U.S. at 456-457), "it was plainly the duty of the district court in the exercise of a sound discretion to have dismissed the petition; remitting respondent if it was so advised to the initiation of a proceeding under Chapter X, in which it may secure a reorganization which, after study and investigation appropriate to its corporate business structure and ownership, is found to be fair, equitable and feasible, and in the best interest of creditors."

2. The court of appeals' view that the decision whether to transfer is a matter for the discretion of the district court reflects an apparently growing tendency in the lower courts to regard Chapters X and XI as alternative remedies, the choice between which lies largely with the debtor. Cf. *Grayson-Robinson Stores, Inc.* v. *Securities and Exchange Commission*, 320 F. 2d 940, 948 (C.A. 2), where the court stated that "Congress has authorized a corporate debtor seeking rehabilitation to follow either of two roads * * *." Since this view is usually coupled with the assumption of broad discretion in the district court to determine whether Chapter XI has been properly invoked, the tendency of this approach is to nullify in large part the reforms in reorganization law and practice which Chapter X sought to achieve.[22]

For the debtor and its trade creditors will almost invariably prefer the "speed and economy" of Chapter XI to the "thoroughness and disinterestedness" of Chapter X (*Realty*, 310 U.S. at 450-451). To the management, a proceeding in which it remains in control and determines the future form of the business is obviously preferable to one in which it is supplanted by a disinterested trustee one of whose tasks is to investigate the conduct of the management. Similarly, trade creditors are likely to prefer the certainty of continued business relationships with

[22] See Rostow and Cutler, *Competing Systems of Corporate Reorganization: Chapter X and XI of the Bankruptcy Act*, 48 Yale L. J. (1939) 1334; Jennings, *Mr. Justice Douglas: His Influence on Corporate and Securities Regulation*, 73 Yale L. J. (1964) 920, 935-941, 952-962.

existing management over the uncertainty of future business opportunities first under an independent trustee and then with a new management. Furthermore, when the district court considers a motion to transfer in such circumstances, it will normally be reluctant to override the deliberate choice of the parties to proceed under Chapter XI. This is particularly so since the scattered public investors are unlikely to be represented at the early stage of the proceedings; and the Commission, with its limited manpower and short time for investigation, ordinarily will be unable to develop all the pertinent facts which, were they known, might be sufficient to persuade the district court to reject the self-serving testimony of the other parties and to order transfer.[23] If, on the other hand, the decision whether to transfer is to be postponed until there has been a more thorough inquiry, the steps which have been taken in the interval in moving forward with the plan of arrangement will make the parties more likely to oppose transfer, and the court more reluctant to direct it.

[23] For example, in *In re Lea Fabrics, Inc.*, 272 F. 2d 769, 772 (C.A. 3), vacated as moot, 363 U. S. 417 (1960), the court of appeals affirmed denial of a motion to dismiss a Chapter XI proceeding and characterized allegations of this Commission as to management improprieties as "vague suspicions." On the ensuing bankruptcy of the same debtor, the district court referred, among other things, to "[management's] conceded looting of Lea's assets," noted that "[management] was 'bleeding' Lea with the knowledge and cooperation of [certain creditors]" and stated "The equities of the bankrupt's innocent creditors must prevail over the claims of the manipulator * * * and his collaborating loan-participants * * *." *In re Lea Fabrics, Inc.*, 226 F. Supp. 232 at 239, 240, 241 (D. N. J. 1964).

In short, leaving it largely to the discretion of the district court to decide whether to transfer cases would result in denying public security holders the protections which Congress intended them to have when it set up the different methods of reorganization provided by Chapters X and XI. For these reasons, we urge this Court to make it clear that a district court has no discretion to refuse a transfer where the rights of public investor-creditors are to be readjusted or, at least, where the proposed plan of adjustment denies them "fair and equitable" treatment.[24]

[24] We do not go so far as to urge that Chapter XI can never be used where a company has publicly-held debt. There might be a case where a composition with merchandise creditors would be sufficient to solve a company's temporary financial problems, and there would be no need to alter the rights of its investor-creditors. See, *e.g.*, *Securities and Exchange Commission* v. *Wilcox-Gay Corp.*, 231 F. 2d 859, 860 (C.A. 6), where, although there were publicly-held debentures, the arrangement approved scaled down only the claims of "general [trade] creditors."

CONCLUSION

The judgment of the court of appeals should be reversed, and the cause remanded with instructions to dismiss the Chapter XI proceedings.

Respectfully submitted.

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AUGUST, 1964.

Table Showing Comparisons of Sections in Chapters X and XI of the Bankruptcy Act

	Chapter X	Chapter XI
1. Initiation of proceeding.	Debtor, three creditors, or indenture trustee may file petition (Sec. 126).	*Only* debtor may file petition (Secs. 321, 322).
2. Appointment of trustee.	Trustee appointed in every case in which indebtedness is $250,000 or more (Sec. 156).	*No comparable provision.* If trustee in bankruptcy has already been appointed, he must be continued in possession. Otherwise, receiver may be appointed "if necessary" (Secs. 332, 343).
3. Qualifications of trustee.	Must be independent, disinterested (Secs. 156, 158).	*No comparable provision.*
4. Examination of Debtor's financial problems and causes of failure.	Trustee investigates property, liabilities, and financial condition of debtor, the operation of the business, and the desirability of its continuance (Sec. 167 (5); *cf.* Sec. 167 (1)). See also Sec. 21 (a).	Court *may* direct examination by creditor or other party of witnesses concerning acts, conduct, or property of debtor (Sec. 21a).
5. Report to judge upon past conduct of the Debtor.	Trustee reports to judge facts pertaining to fraud, misconduct, mismanagement and irregularities, and any causes of action available to estate (Sec. 167 (3)).	*No comparable provision.*
6. Reports to security holders.	Trustee submits statement of his investigation to security holders (Sec. 167 (5)).	*No comparable provision.*
7. Formulation of plan.	Trustee gives notice to security holders that they may submit to him suggestions for formulation of plan (Sec. 167 (6)).	*No comparable provision.*
8. Proposal and filing of plan.	Trustee prepares and files plan (or report of reasons why plan cannot be effected) *before* debtor may propose plans or amendments (Sec. 169).	*Only* debtor may propose arrangement (Sec. 323) or modifications (Sec. 363).
9. Assistance of administrative agency.	In cases in which the scheduled indebtedness exceeds $3,000,000, and in other cases if the judge desires, plans which the judge finds worthy of consideration, after hearing, are submitted to the Securities and Exchange Commission for examination and report (Secs. 172, 173). Commission may, with approval of judge, participate in proceeding as a party (Sec. 208).	*No comparable provisions.*
10. Fairness of plan...	Plan may be approved and confirmed only if "fair and equitable, and feasible" (Secs. 174 and 221 (2)).	Plan may be confirmed if in "best interests of the creditors and is feasible" (Sec. 366).
11. Submission of plans for acceptances.	*After* approval by the judge as fair and equitable, and feasible, plans are transmitted to security holders together with informative materials, including the judge's opinion and the Commission's report (Secs. 174, 175).	*No comparable provision.*

	Chapter X	Chapter XI
12. Solicitation of acceptances.	May not normally be solicited until *after* judge has approved plan and informative materials have been transmitted (Sec. 176).	May be solicited at any time, even prior to institution of proceeding, and must be obtained *before* court confirms arrangement (Secs 336 (4), 361, 362). No requirement as to data which must accompany solicitation.
13. Acceptances required for confirmation.	Two-thirds in amount of each affected class of creditors and majority of holders of stock (if debtor is not insolvent) (Sec. 179).	Majority in amount and number of each affected class of unsecured creditors (Sec. 362 (1)).
14. Dissenting classes of creditors or stockholders.	If a class of creditors does not accept by two-thirds in amount, or if a class of stockholders does not accept by a majority, the plan may be confirmed if it provides for such classes adequate protection as prescribed by the statute (Secs. 216 (7), (8), 179, 221).	*No comparable provisions.*
15. Classes of security holders which plan may affect.	Plan may alter and modify the rights of any class of creditors, secured or unsecured, and of any class of stockholders (Sec. 216).	Arrangement may provide for settlement, satisfaction, or extension of unsecured debts only (Secs. 306 (1), 357).
16. Participation in proceeding by security holders.	Have right to be heard on all matters arising in proceeding (Sec. 206); and may act in person, by attorney, or by agent or committee (Sec. 209).	*No comparable provision.* A creditors' committee may be selected at or before first meeting of creditors (Sec. 338).
17. Control over representatives of security holders.	Information furnished to court concerning employment and interests of representatives of security holders (such as committees, indenture trustees and attorneys), as well as interests of the persons represented (Secs. 210, 211). The judge is empowered to disregard provisions in authorizations of such representatives or to restrain the exercise of powers which are unfair or contrary to public policy (Sec. 212). Claims or stock acquired by the representatives in contemplation of or during the course of proceeding may be limited to actual consideration paid therefor (Sec. 212).	*No comparable provisions.*
18. Indenture trustees.	Have the right to be heard on all matters arising in the proceeding (Sec. 206); to file a claim on behalf of all holders of securities outstanding under their indenture (Sec. 198); and to file a petition initiating the proceeding under the chapter (Sec. 126).	*No comparable provisions* and no mention of indenture trustees.

	Chapter X	Chapter XI
19. Lists of security holders.	Trustee is under a duty to prepare and file lists of security holders (Sec. 164). Other persons in possession or control of such lists or information relevant thereto may be required to disclose the lists or such information (Sec. 165). Although in a proper case the court may direct impounding of the lists, bona fide security holders and indenture trustees have an unqualified right to use and inspect them upon terms prescribed by the court (Sec. 166).	*No comparable provisions.* Debtor files bankruptcy schedules with petition (Sec. 324).
20. Compensation and allowances.	In addition to allowances to officers of the court, the debtor and petitioners, the judge has broad power to make reasonable allowances of compensation and reimbursement for expenses to the representatives of security holders, including committees and indenture trustees, and to individual creditors and stockholders and their attorneys. (Secs. 241–242.)	The debtor is required to deposit the money necessary "to pay the costs and expenses of the proceedings, and the actual and necessary expenses, in such amount as the court may allow," incurred by a creditor's committee (Sec. 337 (2).)
21. Subsidiary corporations.	A petition by or against a subsidiary corporation may be filed in the same court which has approved the petition by or against the parent corporation. (Secs. 129, 106 (13).)	*No comparable provision,* and no mention of subsidiaries.
22. Future management.	Plan must contain provisions which are equitable, compatible with the interests of security holders, and consistent with public policy, with respect to the manner of selection of the reorganized company's directors and officers (Sec. 216 (11)); and identity, qualifications, and affiliations of the persons to be directors and officers must be disclosed and meet same test. (Sec. 221 (5).)	*No comparable provision.*
23. Charter of reorganized company.	Plan must contain provisions requiring inclusion in the reorganized company's charter of provisions for the prohibition of the issuance of nonvoting stock, for the equitable distribution of voting power among the new securities possessing such power, for the election of directors representing preferred stockholders in the event of default in payment of preferred dividends, for the general fair and equitable treatment of securities, and for periodic corporate reports to security holders (Secs. 216 (12)).	*No comparable provision.*

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